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SUBJECT: JORDAN'S ECONOMIC REFORMS AFTER FIVE YEARS:
KEEPING THE FINANCIAL HOUSE IN ORDER (PART 1)

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1.4 (B & D)

1. (C) SUMMARY: Over the past five years, the government of Jordan has carried out a broad range of economic reforms. These have opened Jordan to foreign trade and investment and made the economy run more efficiently. There is hardly an aspect of Jordan's economy that has not been changed, whether in government finances, privatization, trade liberalization, enterprise development, intellectual property protection, or entrepreneurship. Jordan's current economic growth rate of 7.2%, its recent graduation from a 15-year IMF program, and its booming exports to the United States all attest to the government's achievements. The U.S., through its assistance program, played a key role in providing the government with the technical expertise to make many of these achievements a reality. Still-high debt levels, oil prices, poverty levels and the weight of regional political troubles remain real threats to Jordan's long-term economic health. Although transparency has improved, significant off-budget spending continues. Nevertheless, barring a further severe deterioration in any of those factors, or the launch of a major terrorist attack in Jordan, the GOJ appears to have laid the groundwork for continued economic growth for the near future.

2. (U) SUMMARY (cont.): This is the first of a two-part series on Jordan's economic reforms. This cable will focus on the financial picture, including fiscal policy and the health of the banking sector. The second will examine privatization, trade liberalization, the investment climate, and the challenges Jordan will continue to face. END SUMMARY.

MANAGING THE ECONOMY

3. (C) When King Abdullah acceded to the throne in 1999 after the death of his father King Hussein, he inherited a stagnant economy, with per capita incomes actually falling. Investment was low, the total public debt to GDP ratio stood at 111%, and, aside from some success in the regional pharmaceutical trade, exports were largely dependent upon often shoddy goods sent to Iraq as part of the Jordan-Iraq trade protocol. The state played a large role in the economy; in many ways, the benefits of globalization and economic integration with the rest of the world had passed Jordan by. This situation began to change completely after King Abdullah's reign began. Jordan now has become a country with a strong and growing economy blessed with healthy and entrepreneurial sectors such as information technology, and a pharmaceuticals sector that now exports to non-traditional markets, including Europe. The economy is currently growing at a 7.2% rate and the country's high debt levels are falling. Although challenges remain, the government has succeeded in creating a more diverse and flexible economy.

FINANCE MINISTERS AS BAD COPS

4. (C) Abdullah appointed competent technocrats to the ministries overseeing the economy. Jordan has had in succession two excellent Finance Ministers: Michel Marto and his protege Mohammad Abu Hammour, who serves as the current Minister. Although some doubted Abu Hammour's capabilities when he was appointed one year ago, he has succeeded in winning over the doubters and was just reappointed as Finance Minister in the recent Cabinet re-shuffle. Planning Minister Awadallah has complained to Charge that Abu Hammour "thinks like an accountant"-- which is exactly what's needed to keep spending down.

5. (C) Marto, who now heads a leading bank in Amman, described the role of the Finance Minister as the tough guy in a "good cop, bad cop" scenario. The King plays the benevolent leader and uses the stubbornness of his Finance Ministers to fend off other ministers seeking extra spending. Marto said the King had liked him because he was the only minister who ever said "no." According to Abu Hammour, he himself played the same role in the recent government and he expects to continue saying "no" after his reappointment.

FISCAL DISCIPLINE

16. (C) Abu Hammour has held the line on government spending, often in the face of intense lobbying by other ministers, parliament, and the military. In 2004, Abu Hammour succeeded in increasing the minimum number of years needed to receive a pension by five years for civil servants and by four years for the military. Equally sensitive in this country where the military is held in high regard, he ended the practice of promoting officers automatically upon retirement, thereby increasing their pensions. The military is a pillar of the monarchy, and Abu Hammour could only have taken these steps with the blessing of the King.

17. (C) After a long skirmish with Planning and International Cooperation Minister Bassem Awadallah, Abu Hammour succeeded in convincing the King to include the Planning Ministry's Social Economic and Transformation Program as part of the overall budget process. It had previously been run off-budget, but will now fall under the capital expenditures control of the budget, as recommended by the IMF, and as required by a condition precedent for release of USAID budgetary support funds.

18. (C) Using the recommendations of the IMF as political cover, Abu Hammour raised the General Services Tax from 13% to 16% in April 2004. (The IMF had only called for a 2% increase). At the same time, he won an average 9% increase in the price of fuel products. Both moves affected every Jordanian and were politically difficult steps. Yet, reforms will continue and USAID is currently designing a fiscal reform project to assist the government with more extensive reforms.

19. (C) Thanks to these steps, total government expenditures have fallen by one percent, with a reduction in current expenditures more than offsetting a slight increase in capital spending. Excluding foreign grants, the government's budget deficit fell by 59.6% (\$393.4 million) in the first seven months of this year as compared with the same period last year. When the declining level of foreign grants is factored in, the budget surplus of only \$8.7 million in July 2003 rises to \$77.7 million in July 2004.

DEBT

10. (C) One of Abu Hammour's main worries is about the country's still-high debt levels. As of September 30, 2004, Jordan's public debt outstanding reached \$9.6 billion (89.5% of estimated GDP) of which \$7.3 billion is external and \$2.3 billion is domestic. Although these numbers remain very high, they are down from a recent peak of 111% of GDP in 1999. Unfortunately for Jordan, 19.9 % of its public debt is in euros and 22.6% in Japanese yen. Abu Hammour recently said that the appreciation of the euro alone had added \$1 billion to Jordan's debt stock.

11. (C) Driven partially by a Debt Management Law which requires him to lower Jordan's overall debt/GDP ratio to 80% by a government-set deadline of 2006, Abu Hammour has been pushing a variety of debt reduction measures. In December 2003, Jordan bought back from the U.S. all of Jordan's stock of Brady bonds (Amman 1456). In the past year, Jordan also concluded debt swap agreements with Britain, Germany, and Italy.

12. (C) Now, Abu Hammour has turned his attention to Jordan's Paris Club debt. According to the Paris Club Agreed Minute of July 2002, debtor countries have the option of carrying out debt swaps amounting to 30% of their total debt or up to 40 million euros, whichever is higher. Jordan has already reached this maximum for some creditor countries and Abu Hammour and the government are lobbying hard to raise the 30% limit to 50% in order to reduce both the debt/GDP ratio and the debt service.

TRANSPARENCY IN GOVERNMENT DATA

13. (C) The government and the Finance Ministry in particular have been in the forefront of making Jordan's economic data available--arguably in advance of the region. In May, the Ministry began publication of a quarterly report on its internal and external public debt. According to an IMF official, it is the only such report in the Middle East. The official also said that Jordan's government was one of the most open in the region in terms of the financial information it made public. The information includes the national accounts statistics, price statistics, government finances and balance of payments statistics. Illustrating that this openness is not limited to the Finance Ministry, the Director General of Jordan's Department of Statistics

recently told emboffs that, in his view, the statistical data his agency produced should be seen "as a public good."

¶14. (C) However, Jordan still has a long way to go toward fully rational budgeting and total transparency. Off-budget spending continues, for example the Planning Minister's benign if sometimes uncoordinated Social and Economic Transformation Program, which has spent about \$300 million over the past three years outside Finance Ministry control, with another roughly \$440 million remaining to be spent. Of more concern are the unconfirmed, but credible, reports of palace and security service slush funds, and the cronies whose names regularly appear among the winning bidders for big government contracts. The perception, as much as the reality, of corruption, infects public life in Jordan and probably diverts much potential foreign and domestic investment.

HEALTHY RESERVES

¶15. (U) The healthy state of Jordan's foreign exchange reserves is another indicator of the government's success in managing the economy. When Abdullah became King in 1999, Jordan's reserves stood at \$2 billion, or equal to approximately 4.8 months of imports. Today those figures are \$4.7 billion of reserves, covering 9.5 months of exports.

THE BANKING SECTOR ENJOYS THE BOOMING ECONOMY

¶16. (C) Competent financial leadership, combined with the influx of business related to Iraq, has helped Jordan's banking sector enjoy a mini-boom. Net after-tax profits of the banking sector rose 27% in 2003 and are expected to break that record in 2004. The balance sheets of banks are stronger and the level of non-performing loans fell from 17.5% in 2002 to 15.8% in 2003. One Jordanian bank, Housing Bank, is on the verge of breaking ground on its new headquarters, which would be the tallest building in Amman. Three of Jordan's banks are looking farther afield and have been granted licenses to open branches or buy into banks in Iraq, although launching services there remains a huge challenge.

¶17. (C) Underlining the strength of the sector, the IMF's 2004 financial stability assessment concluded in 2004 that the country had no substantial fiscal vulnerabilities, and that the banking system generally showed high capital ratios, liquidity and profitability. However, Jordanian banks have been criticized for being too cautious and unwilling to lend; a complaint often heard from new entrants to the market and from small and medium enterprises. In addition, the sector could benefit from consolidation; there are too many small banks unable to benefit from economies of scale.

COMMENT

¶18. (C) Jordan's economy under King Hussein was characterized by a mix of tribal largesse and statist job protection. One of King Abdullah's most important initiatives has been to begin to transform the economy into a competitive marketplace, and to rationalize management of the economy.

¶19. (U) Baghdad minimize considered.
HALE